Minutes
Joint Legislative Program Evaluation Oversight Committee Meeting
August 3, 2009

Members Present

Co-Chair, Fletcher Hartsell
Co-Chair, Dan Clodfelter
Senator Charlie Albertson
Senator Peter Brunstetter

Co-Chair, Representative Nelson Cole
Representative Bruce Goforth
Representative Ty Harrell
Representative Hugh Holliman
Representative Carolyn Justice
Representative James Langdon
Representative Paul Luebke

Call to Order

Co-Chair Senator Fletcher Hartsell called the meeting to order.

Actions Taken

The Committee approved the Minutes of the July 6, 2009 meeting as presented.

HEARING ON STATE PURCHASING AND CONTRACTING

Co-Chair Fletcher Hartsell stated that the purpose of the meeting was to receive agency suggestions for legislation or other policy changes to correct problems about state personal property and service contracting as reported to this committee by the State Auditor on July 6, 2009.

Don Teeter, Special Deputy Attorney General, Division of Property Control of the Department of Justice

Senator Hartsell recognized Mr. Don Teeter, Special Deputy Attorney General of the Property Control Division of the Department of Justice to make a statement and respond to questions.

Mr. Teeter said that the Secretary of Administration is required by N.C. Gen. Stat. § 143-49 (3) to ask for assistance from the Attorney General's Office in negotiating with prospective contractors for contractual services contracts exceeding a cost of $100,000 and to maintain files for three years. The greatest portion of service contracts are performed competitively and do not require negotiations. Teeter described his experience when he was with the Attorney General's Office in the late 1980's negotiating with EDS for a medical database contract. Relative to the State Health Plan contract at issue, Mr. Teeter said that the State Health Plan prepared the contract with Blue Cross and that the Attorney General's Office was not involved in negotiating or preparing the contract. The State Health Plan handled the negotiations independently and Teeter suggested that the State Health Plan obtained any legal advice elsewhere. Teeter opined that there is a certain critical mass of lawyers needed during negotiations and that exceeding that critical mass means that "nothing is going to happen." The policy person, usually the agency head determines the need for legal advice and if the agency head asks for advice from Teeter or his attorneys, they give that advice. Teeter said, "The current administration has done a superb job in asking for legal services when they need them." Teeter has one staff member dedicated to serving the current administration. Teeter said his office could make improvements and with more staff that his staff could provide services that are more thoroughgoing on contracts and in smaller increments.

Representative Nelson Cole asked why the Attorney General's Office refused to respond in writing to the Program Evaluation Division's questions for background prior to today's hearing. Mr. Teeter said that the written response was an issue "above (Teeter's) pay grade" but that he understood that the Attorney General's Office had informed the "Chief of Staff" (Director of the Program Evaluation Division) that the office respectively declined to make a written response. Representative Cole asked again if this meant that the Joint Committee had asked for a written response and that the Attorney General had refused to respond. Teeter said that was correct. Representative Cole said that the refusal was an insult. He said that he did not have any questions of Teeter because the office had refused to provide written answers.

Senator Daniel Clodfelter asked how many lawyers worked in the Office of Property Control. Mr. Teeter said five lawyers plus himself. Senator Clodfelter asked if the statutes required any agency or offices other than the Secretary of Administration to consult with Teeter and his attorneys about contracting. Senator Clodfelter asked if his understanding of the N.C. Gen. Stat. § 143-49 (3) was correct that the attorneys under Mr. Teeter's supervision reviewed only contracts let by the Department of Administration. Mr. Teeter responded that this was correct and that his staff responded to numerous issues on a daily basis affecting the Department of Administration on personal property procurement, construction, and real property procurement.

Senator Clodfelter asked if Property Control attorneys had veto authority over those contracts submitted for review analogous to the Senator's local government experience that the City Council could not approve a contract unless counsel had approved the contract, i.e. counsel had veto power. Teeter responded that some of the construction contracts come to them for approval "as to form," which means, "It is written on white paper in reasonably dark ink and signed by pretty much the right people. We do not approve as to substance and content." His office "did a great deal of work with all of the divisions of the Department (of Administration) with respect to questions about how to do things and how not to do things, questions about bidding and questions about the law."

Senator Clodfelter asked if the Property Control Office had reviewed the Division of Medical Assistance contract that Teeter mentioned earlier. Teeter said the Property Control Office had not reviewed the contract but that another office in the Department of Justice may have.

Representative Bruce Goforth asked if the laws protected the interests of North Carolina businesses when competing for state agency business and gave an example of a large contract involving recent federal stimulus going to an out-of-state company, which generated many complaints from his House district. He asked what latitude the General Assembly had to make the purchasing laws work in favor of North Carolina companies. Teeter said that the state could consider "price, time to delivery plus two or three but a very limited number of other things," but that in general "unless you can hook it (the bid award) to price, you may be getting off the edge of the map." However, with federal stimulus money, the state could assure that funds benefited the North Carolina economy, unless an action changes who wins the award in a close case. There are potential federal constitutional equal protection issues with legislation that gives preference to in-state bidders. There is also very little way to pass a statute without starting a "border war" that could have a retaliatory effect on North Carolina businesses doing business in other states. Teeter likened the situation to "ripples in a pond." Teeter said that the "black letter law" relative to public procurement is "not there for the care and feeding of contractors," but to protect the public and to get the "best bang for the buck for the taxpayers." The General Assembly can and should strike a balance between protecting local employers and North Carolina businesses and the interests of the taxpayer.

Representative Goforth reported that he knew of out-of-state architects hired for state construction projects who wrote building material requirements to favor businesses in the architects' states, which resulted in both lost business to North Carolina as well as higher prices and which is a huge problem in universities.

Senator Clodfelter noted that N.C. Gen. Stat. § 143-49 (3) appeared to limit Property Control attorneys authority to provide advice only on contractual services and not on purchases of supplies and equipment. Senator Clodfelter asked if those attorneys reviewed the office supplies contract at issue. Mr. Teeter responded that one of the lawyers in his office was involved in the formation of the RFP for the contract. There were two contracts "back to back" and litigation with one of the losing bidders for three months. The great number of products covered by that contract and the E-procurement system, which allowed ordering products over the web without purchase orders, were new experiences for the Department of Administration involving a great number of products. The web system provided a cost savings in reduced paperwork processing. Teeter suggested that the General Assembly might determine what agencies should do to order and receive products more quickly. He said that he "could not swear to this" but that he believed that the Department of Administration Purchase and Contract Division requested Teeter's advice on potential pricing problems with the contractor before the State Auditor identified those problems. Teeter advised the Division to turn the matter over to the State Bureau of Investigation, as the statute requires, and to continue reviewing the pricing problem internally. Teeter said that the State Bureau of Investigation did not detect criminal activity. The Purchase and Contracts Division continued to "get after" the vendor about pricing and recovered money paid for overcharges and stopped Office Depot from recovering for a "substantially larger amount of money that Office Depot had undercharged." Teeter agreed with the current and previous State Auditors criticism "that this was no way to do business," but noted that oversight of the online price charts was an unfamiliar area for the Division of Purchase and Contract and that the Division wanted to simplify the process of getting these goods "in the door." Teeter said that the Department of Administration decided instead of litigating to terminate the contract at the first opportunity after its remaining one year of commitment and then rebid the contract.

Senator Clodfelter said that he agreed with concerns expressed earlier (about the Attorney General's refusal to provide written answers before this hearing). Senator Clodfelter noted in addition to the three contracts criticized by the Auditor that this joint committee had received a report about a fourth contract earlier this year as part of an "absolute fiasco" with Administrative Office of the Courts technology contracts, which are currently exempt by statute from oversight by the Department of Administration. The General Assembly may wish to review that exemption. He commented that a critical mass of attorneys has to be something in excess of zero. The four contracting issues resulted from an absence of anyone "blowing the whistle," questioning and then halting contracts before they went into effect. There are many other examples within state government not represented by the four in question. Senator Clodfelter expressed concern that the Attorney General as the state's legal representative had not provided suggestions to this joint committee for legislation within the resources and realm of possibilities for addressing problems and therefore had left the joint committee adrift, which was not a satisfactory situation.

Teeter said that he "would certainly carry that message back."

Senator Hartsell said that he recalled a body of federal law and statute that allowed renegotiation of procurements and contracts primarily in the military area. Senator Hartsell asked Mr. Teeter if North Carolina had a similar provision permitting or requiring the renegotiation of procurement contracts under certain circumstances.

Mr. Teeter said that the Federal Acquisition Regulations (FAR) permit the agency contracting officer to invite two or three of the best bidders to propose a "best and final offer" (BAFO). North Carolina does not allow this. State government follows a policy of "tell them what you want, take their bids, and buy at the lowest price." The toughest decisions are when agencies may allow a bidder to clarify bids. The "holy grail of that is" that one bidder may explain features of the product and to negotiate items of better quality, but the bidder will not be allowed to bid a different price during

clarification. North Carolina law generally does not allow negotiations with bidders particularly on personal property acquisitions after receiving bids. The law does provide more leeway for construction contracts, which the State Building Commission regulates and statutes address. Mr. Teeter suggested that some of the procedures allowed for purchases during construction including ability to use "single prime, multi-prime and construction manager at risk" types of construction delivery with Building Commission approval and allowable for local governments might be welcome, beneficial and save money on personal property acquisitions if the law allowed.

Without further questions or comments from the committee, Chairman Hartsell excused Mr. Teeter.

Dr. Jack Walker, Executive Administrator, State Health Plan for Teachers and State Employees

Co Chair Fletcher Hartsell recognized Dr. Jack Walker, Executive Administrator of the State Health Plan for Teachers and State Employees to make an opening statement and respond to questions.

Walker said that the State Health Plan (SHP) has about 665,000 members including active employees, retirees, and their dependents. The former Executive Administrator of the SHP entered into the Blue Cross Blue Shield (BCBS) administrative contract criticized by the State Auditor on February 2006 as a "cost plus" contract, had no caps, no reasons for any cost savings initiatives, and lacked any requirements for reporting BCBS costs. It was a cost plus contract with not many requirements for reporting costs. As pointed out by the Auditor, the contract had weak provisions for auditing. Questions received have included "Are bonuses allowed?" "Can marketing expenses of BCBS be charged to the plan?" "How is overhead to be allocated?" A host of things should have been done that were untouched during the negotiations of this contract. In addition, the contract provided that certain portions of administration were to be charged to claims expense, which resulted in understatement of administrative expenses in reports to the General Assembly and others because BCBS took part of the administrative expenses and put them "in the medical claims bucket." As a result, it "looked like administrative expenses were at one level, when in fact they were significantly higher than that." It specifically says in the agreement that a certain portion of administration was to be included in claims expense.

Dr. Walker referred to the written responses to questions posed by the Program Evaluation Division and to a handout distributed during the meeting. In 2005, the administrators of SHP obtained approval from its Board of Trustees to create a PPO option on a sole source basis. This contract cost in excess of $100,000,000 per year. It was not bid. Two people from the State Health Plan were involved in negotiations—the Deputy Administrator and Chief Operating Officer and the Network Administrator. The Attorney General's Office was not involved. The Division of Purchasing and Contracts was not involved. "As far as I can tell" no outside attorney was involved. "But they followed the law." They had to advise the General Assembly and they did. They had to get the consent of the board and they did. "So, from what we can gather, there was no non-following of the law." Very few of the SHP staff were involved, "So it was a very tight knit operation." "I don't know how many on the Blue Cross side were involved." The former Executive Administrator signed the contract on Feb. 28, 2006. In addition there was a comprehensive major medical plan still in existence and the PPO was offered in addition to that and that contract was due to expire. The previous administration went to the board and said they wanted to extend this comprehensive major medical contract for three years. The board approved. The SHP also notified the General Assembly. So that contract was also extended. Again, no bid, "Just extended, I presume under the same terms and conditions."

As to actions taken as a result of the State Auditor's criticisms, Walker said after 2006, the SHP administration decided that they needed to control contracts administration better and it did create a contracting administration department, developed a policy and procedure manual, which is in effect

today with revisions and will be revised again. All of this was done after SHP signed the current BCBS contract.

Walker said the SHP is now seeking advice on all contracts where appropriate from the State Auditor. The SHP is doing what Walker termed the "5-G RFP," which was in Senate Bill 287 calling for an extensive audit of SHP contracts and has worked with Program Evaluation, Purchase and Contract, and an Attorney General's Office attorney dedicated to SHP who is consulted on all contracts. SHP also has an in-house attorney. Walker commented that he did not know as the committee discussed earlier in this meeting whether SHP having two attorneys approached a "critical mass." SHP will continue training staff on contract administration.

Walker said that SHP eliminated the "shared savings" component, which was in the current BCBS contract because it incorporated some of the administrative costs. The rate is now a quarterly per member per month rate for administrative costs and then BCBS adjusts from that. The SHP is now getting a monthly report of charges. Previously BCBS sent a bill for a lump sum amount BCBS said was owed for the month—no detail, "just this is how much was owed for the month of…." Today, SHP is receiving a bill, which is broken down into charges for categories of service, for every major administrative duty required of BCBS.

Walker said that the audit provision stated that BCBS had the right to approve any outside auditor, "to read the audit report, and the right to tell the SHP what it should know." The State Auditor reported that this was "kind of weak." We amended that contract August 17 and the outside auditor works for "us" (the SHP). The auditor will report to SHP "without censorship" what they find. There are more things that SHP wants "to work on" relative to the claims processing contractor. The SHP is getting very good cooperation out of BCBS today as well as very good detailed records and has discussed improvements with BCBS. SHP has done some cost reduction strategies with BCBS. They have been cooperative—someone simply "needed to knock on their door and say 'This is what we want.'"

Walker said that SHP is working on final details of an engagement with a local CPA firm Thomas and Gibbs for auditing administrative expenses and do some limited operational and efficiency work. SHP is focusing the "5-G RFP" to obtain a firm for a full efficiency and operational audit and hope to have the RFP finished by August 15, select a vendor by September 15, and report results to the General Assembly and Blue Ribbon task force as findings emerge from that audit.

Walker said the current contract with BCBS ends June 30, 2013. SHP intends to begin writing an RFP thirty months out around the first of 2011 to bid the next contract. The RFP development will be extensive. The contract will be a fixed price contract, not a cost plus.

Walker explained the SHP written response to the Program Evaluation Division that it did "not have any legislative corrections at this time." The SHP suggests instead of offering preliminary and tentative recommendations better recommendations will result from the Blue Ribbon Task Force review of the claims and efficiency audits.

Walker said that his concern is governance of the SHP. The Executive Administrator has sole authority without much oversight over many major areas affecting the plan. The General Assembly needs to examine this authority carefully and specify the authority of the Executive Administrator. Walker gave an example. Until the General Assembly passed legislation very recently, the Executive Administrator with only some concurrence by the board could change dependent rates, which could have had major cost implications. The examination should include the extent of authority over the administrator by part time board members that meet only quarterly and can be easily swayed. SHP pays the part time members only $100 per meeting.

Representative Holliman asked if SHP could realistically expect a number of claims administrators to handle the number of claims handled by SHP. Walker said that he wished that he could say that there were several, however BCBS is "very strong in this state" and that there could possibly be one other that may be only marginally qualified. The rest "would not be able to give a 100% provider network."

Representative Holliman asked if it was not true that the SHP benefits because the administrator has a statewide provider network. Walker responded that BCBS pricing is "excellent" because SHP benefits from services provided at a discount to BCBS by its network. Representative Holliman asked if the SHP were to change, that SHP would have to adjust to a newly formed network. Walker said that the SHP anticipated that issue by planning to issue the RFP in 2011 to provide a good bidder a year to prepare.

Representative Harrell asked Walker to clarify what he had verbally consulted Mark Trogdon of the Fiscal Research Division about earlier relative to recent legislation addressing the SHP Executive Administrator's authority to raise dependent rates. Walker said that he knew the legislation passed the Senate but was not sure it passed the House.

Mr. Trogdon said that HB 1274 up for third reading that night has a provision requiring that the General Assembly approve dependent rates. The law currently provides that the Executive Administrator and SHP Board can actually set all rates unless otherwise set by the appropriations act. Historically the General Assembly has set the employee rates in the appropriations act and subsequently the Executive Administrator and SHP board have set the dependent rate. Mr. Trogdon said that Walker has recommended the General Assembly set all rates.

Representative Goforth asked Walker what percentage bonuses paid to BCBS employees represented of the overhead charged to the SHP. Walker responded that the SHP will know that answer sometime between August and December. Representative Goforth asked if BCBS included advertising. Walker said that too would be forthcoming between August and December. Representative Goforth said that we apparently have an unknown cost plus percentage basis. Walker said the SHP "had whatever cost the administrator (BCBS) decided to put into overhead." Representative Goforth said, "That is scary."

Representative Cole asked who appointed the SHP Board of Trustees and if there a corporate structure or nonprofit structure allowing for that method of appointment and board responsibilities as well as board member qualifications. Walker said that three each are appointed by the Governor, Speaker and Pro Tempore and within that it is specified one must be a teacher, another a state employee and the other a retiree. However, other than that, there are no other qualifications. They have fiduciary responsibilities and the Executive Administrator "runs approximately 140 things past them during the year, which is nearly impossible" because they meet only four times a year with occasional teleconferences. Representative Cole requested that Walker provide the joint committee and PED staff the names of those trustees. Walker said that he would furnish the names to PED staff.

Without further questions or comments from the committee, Chairman Hartsell excused Walker.

James Staton, State Purchasing Officer, Department of Administration Purchase and Contract Division (P&C)

Co Chair Fletcher Hartsell recognized Mr. James Staton, State Purchasing Officer from the Department of Administration Purchase and Contract Division to give opening statements and then respond to questions.

Mr. Staton reviewed responsibilities, functions performed, and scope of work under N.C. Gen. Stat. § 143. He said that the division has 42 employees including 17 procurement specialists, 3 compliance officers, 2 trainers and educators, 3 engineers, 5 managers, and 9 support personnel. Mr. Staton noted that Walker had responded to questions about the SHP. He said that recommendations made by the State Auditor have been implemented. The division issued a new office supply contract, awarded to four contractors, and established control of product pricing and ID numbers. He does not anticipate further problems. Two of the four contractors are "women only" companies. The contract included penalties for failure to perform. Staton said that even though the Auditor recommended automated contract monitoring, he believed that the current contract achieves the intended results until resources are available for others to develop software to monitor contracts on a statewide basis. He added that the process he reviewed represented efforts to improve from lessons learned. Office Depot credited contract overcharges back to the users.

Representative Holliman asked if P&C is able to keep up with contracts on a timely basis with the current number of employees. Staton said that he did not have metrics on the average processing time. In addition to the number of contracts, the dollar or volume of the contract would be factors in workload. P&C considers 30 days to complete all steps of an acquisition a success, but the time needed depends upon the nature of the contract. Even with a very large staff, turnaround depends upon the magnitude of the contract.

Representative Holliman asked if agencies gave P&C sufficient lead time or do agencies ask for approval on short notice. Staton said that this did happen occasionally and his staff works with agency staff to prevent this by asking agencies to let P&C know of work in process toward a contract submission. Staton said that P&C review including his reading of contracts did not constitute a bottleneck.

Representative Cole asked whom Mr. Staton considered the customer of P&C. Mr. Staton said that customers or stakeholders included state agencies, suppliers, and taxpayers. Representative Cole requested Mr. Staton to prioritize the three and name the most important. Staton said that meeting the needs of the state agencies is the top priority and then state vendors. Representative Cole commented that he considered state residents the customer and that P&C should do so as well. Staton said that he did not disagree.

Without further questions or comments from the committee, Chairman Hartsell excused Staton.

Dan Stewart, CPA, Assistant Secretary for Finance and Business Operations, DHHS

Co Chair Fletcher Hartsell recognized Mr. Dan Stewart, Assistant Secretary for Finance and Business Operations, Department of Health and Human Services (DHHS) to respond to questions following an opening statement.

Mr. Stewart said that his response would cover questions raised by the State Auditor about the Value Options contract: The DHHS Division of Medical Assistance (DMA), which handles Medicaid, had overall responsibility for the Value Options contract with the DMA contracts section exercising primary responsibility. The contracts section currently handles 86 active contracts with some of the contracts over 1,000 pages in length. The section is also responsible for 10 current requests for proposals (RFP) as well as development of proposed contracts. The section consists of 3 people working on contracting and another 3 who are monitors. Contracts collectively represent a value of $230 million. Not only are the contracts very large, there are often many amendments. For example, the EDS fiscal agent contract has 76 amendments and is now up to 2,000 pages in length.

Stewart said that in addition to actions taken in response to the State Auditor report, the DMA contracts section has done several things to improve documentation for contract monitoring:

- Identified appropriate documentation, which is maintained on an on-going basis to reflect the original projected costs of the contract per year along with the actual reviews provided and the costs incurred
- Began using RAT STAT software (also used by the OIG on the federal level) in the Fall of 2008 with the assistance of the DHHS Internal Auditors to sample reviews identified as duplicates in the monthly invoices and data received from Value Options
- Developed a database in the winter of 2008 to handle over 60,000 lines of data received each month by DMA from Value Options in support of their monthly invoice, which comprises about 1,200 pages each month, to ensure the invoice and data support each other. Additionally, logic has been built into the database to identify duplicate billings. This logic was based on discussions with Value Options and DMA Clinical Policy staff. There is documentation for the database as well as a checklist by which these monthly reviews of the Value Options invoice and billing data are reviewed. On-going discussions are conducted between DMA and Value Options.
- Developed more in-depth review processes of the monthly performance reports.

DMA has gradually diminished the amount withheld before payment to Value Options. DMA imposed the "withhold" until DMA and Value Options cleared up billing problems. DMA has gradually reduced the "withhold" to 3% currently. Any adjustments DMA finds are handled through the monthly invoice process.

Representative Harrell asked how many duplicate bills have been submitted by Value Options.

Stewart said that the issue was not duplicate billings, but a single request for services resulting in duplicate entries. When a request for service comes in for prior approval sometimes there may be follow-up activity with the client or with the provider. Initially with the follow-up, there were additional billings. The billing process is involved and complicated. Stewart said that he is a CPA and that half his career has been in auditing and half in administration. With this background, Stewart suggested that the committee could "take his assessment of the process to the bank as being very involved and complicated."

Representative Luebke commented that the issue that has been in the media and before this committee several times was what Value Options was billing for—that is low risk services and that services for higher risk consumers were not offered that often. Thus, Value Options was billing mostly for low risk services or certainly low priority services from the perspective of Representative Luebke and others concerned about the nature of mental health services. Rep. Luebke asked if Stewart's office was involved with this services issue.

Stewart said that his office was not. He said that Value Options performed a prior approval processes and is an agent of the State as is EDS. The providers of services would send requests in to Value Options for a particular service for prior approval. Based upon that information Value Options would question the provider about that service and approve or deny services to a recipient and of course the provider.

Representative Holliman asked if it was correct that at one time Value Options was approving every service requested.

Steward said that was correct. Early on requests for support program services inundated Value Options. There was a lot of provider abuse. The volume of claims was more than anyone had imagined. The problem was getting a sufficient number of staff "up to speed" to handle those requests to assure that those who needed services got those services. Yes, early on Value Options

was approving almost every request. As Value Options staffed up and could contact providers for additional information the approval rate dropped and dropped again.

Representative Justice said that she served on the Mental Health Oversight Committee when the committee first considered the Value Options issue and that there was "much gnashing of teeth" and reluctance to proceed out of concern that there would be too many problems with the transition. Then the problems occurred as many had predicted. She asked Stewart if the problems would be solved a year from now if an assessment were done at that time.

Steward responded that Value Options was making improvements all along, that the issues in the audit report would largely be solved by then, and that most have been solved as of now although there is always room for improvement. The volume of transactions going through the DMA contracts section exceeded the capacity of staff available. An individual reviewer has limits to the number of transactions that can be handled to the degree of depth required.

Stewart said that PED asked DHHS what legislation that DHHS would request. He said that the issue was not a need for legislation, but a need for manpower resources. The General Assembly has passed legislation that had assisted in this area. However, the workers available had difficulty handling the claims volume from 50,000 providers. The DMA appeals process resulted in a backlog of 7,000 appeals and claims that could not be processed earlier. Appeals require claims staff to stop processing to attend appeals proceedings.

Representative Justice commented that she was glad to hear that DMA had introduced logic into the system and that government needed to introduce logic nationwide.

Senator Clodfelter commented that we needed to know what happened in the past to be able to craft a solution for the future. He reported confusion as to what actually happened from the answers to some of the earlier questions about Value Options suddenly approving all of the requests for authorizations. Clodfelter said that he thought that the DMA had simply switched off the interface function, which was not the same as Value Options approving all requests. He said that he understood that DMA said, "Don't worry with authorizations for now."

Stewart responded DMA recognized early on that there needed to be a prior approval process. The initial claims volume exceeded anticipated volume. Value Options does a number of prior approval services for DHHS.

Senator Clodfelter asked if the failure was Value Options authorizing services that it should not have authorized or if it was DMA saying that it could not handle the approval process.

Stewart responded that the problem was that the volume exceeded Value Options capacity and that the waiting process would have resulted in people needing services not receiving those services. Then the opening up of prior approvals also resulted in people not needing services receiving services.

Clodfelter asked Stewart if it was true that the people who should not have received services received them not because Value Options granted prior authorization for those not in need, i.e. the error was not a Value Options error.

Stewart said "Yes."

Senator Hartsell recognized State Auditor Beth Wood for a comment.

Wood said that one of the audit findings was that DHHS did not do enough work up front before entering into the Value Options contract. Value Options software could not communicate with DMA software system. The DMA system rejected many of the claims for which Value Options had issued prior approvals. Because of the high rate of DMA rejections of claims previously approved by Value Options, DMA turned off the DMA system edits that rejected claims. The result was that the State paid Value Options for a prior approval system that could not "talk" with the DMA system so the State turned off the State system.

Senator Clodfelter asked Stewart if the State Auditor's explanation was correct.

Steward said that the State Auditor's explanation was correct. He added that EDS handled the DMA system. The system has over 4,300 audits and edits of which some were original and some added later as patches during the system's 30-year history. The EDS system was denying too many valid claims because some of those EDS system edits added over time were not working properly. So DMA turned off all edits until DMA could fix the EDS system.

Representative Holliman asked what the State did wrong in contracting with Value Options without any idea about the volume.

Stewart said that his personal opinion was that what started the problem was when the US Center for Medicare and Medicaid Services (CMS) said that they were not going to allow certain services for the mentally ill. DHHS put in a new service definition to "pick up the slack" and people would not "slip through the cracks." DHHS wrote the definition broadly to cover people who were losing services and cover them under the new definition. Some abusive providers took gross advantage of everyone involved. The US CMS approved the definition. Another issue was that CMS would not allow DHHS to phase in from the former service to the new service. Stewart did not remember the date, but on a midnight, DHHS had to switch from one service to another. That led to some of the issues that Stewart explained earlier about Value Options approving services. There was not enough time to get everyone through the system. At that midnight, DHHS had to take everyone in the state who was receiving services and move them to another service. DHHS had asked CMS for a phase in and CMS denied the request.

Representative Luebke asked why there were no cost controls or a system to identify how much money DHHS spent on these low-level services as opposed to services to more needy clients.

Stewart responded that one could identify a number of areas, but one of the primary areas is that DHHS is behind in technology. There are always limited funds to create a dashboard to flag problems early instead of identifying those up to five months later. This could occur in any area of the department such as Medicaid or another section. DHHS is trying to fast track a particular element under the new Medicaid system. It will be a software system or an analytical tool that will identify these cost overruns as they happen and enable management daily to identify anything out of kilter with the budget. Because DHHS is participating in the Medicaid Management Information System (MMIS) project, the federal government will finance ninety percent. DHHS will have resources available above what are normally available. If management identifies a problem, however, management cannot simply throw a switch to stop it. If DHHS has an approved service definition, changes have to flow through CMS through the Atlanta regional office and ultimately to Baltimore. CMS has a "ninety-day clock" to stop things any time they have questions. Sometimes it takes CMS a long time to approve state plan amendments. It took CMS on one occasion three years to approve a plan amendment. In the meantime, DHHS is spending money, even if DHHS is aware of a needed change, because of federal approval requirements.

Representative Luebke asked why someone in DHHS did not "blow the whistle" on how much money was going into the low-level services. He noted the chart in the Program Evaluation

Division briefing showing the spike in spending after only one month. He asked if Stewart was saying that DHHS had no technology that would have identified the sharply increasing expenditures.

Stewart said that the North Carolina Medicaid program is a $10 Billion program. After sixty days, the DMA director brought the spending escalation to the attention of the DHHS Secretary. The Secretary's office started reviewing the matter and started the process of tightening the definition for CMS approval, which is very lengthy. Meanwhile, there were the abusive providers sending in requests "by the boatload." That affected the Value Options contract. When Value Options would turn down services, providers and recipients would file appeals to the DMA appeals section. The section had a backlog of 7,000 pending appeals. Assembling people in from several DHHS sections, Value Options and DMA appeals staff was a "virtual nightmare." There are no options with services— because of federal regulations services DHHS cannot stop services suddenly. DHHS was spending money while the mandatory of appeals process was backlogged. It is not a "flip a switch" type situation unfortunately. There has been a lot of money wasted as a result.

Representative Luebke commented that what happened was unacceptable. He repeated that Stewart earlier had said that lack of technology was the cause of the problem. He asked Stewart that if in a year DHHS would have the necessary technology.

Stewart said that DHHS has pieces of technology. For example, the interface between EDS and Value Options is working. The contract-monitoring piece is in place. Many other pieces are in development that hopefully will be under contract shortly. Stewart said that he was hopeful that a dashboard would be available by January 2010 covering the entire Medicaid program that will allow DHHS to identify any exceptional usage of a particular service early on. Stewart said that he could not promise that the situation would never happen again. However, DHHS would be able to identify such situations sooner. The things that DHHS does not control such as CMS approval of state plan amendments that may take from ninety days to three years. DHHS has no control over the number of provider and recipient appeals and services and DHHS has to continue services until that appeal is completed. DHHS only has six hearing officers handling appeals. DHHS hopes to have identification of such problems much earlier than in the past.

Representative Luebke commented that Stewart should have a direct line to the Secretary. In spite of the delays and appeals mentioned, the state still experienced huge amounts of money wasted on low intensity services. Representative Luebke expects Stewart to have a direct line to the Secretary for an immediate alert when problems are first identified. He asked if Stewart was saying that Stewart did not have that power now.

Stewart said that the Secretary does not have that power.

Representative Luebke asked if that meant the Secretary did not have the power to end the Value Options "mess."

Steward responded that Value Options "was approval." The Secretary did not have the power to make necessary changes to community support services that CMS had approved in the state plan amendment.

Representative Holliman asked if DHHS wrote the original service definition.

Stewart said yes the department wrote the definition, which CMS approved. He added that there is considerable interchange and a negotiation process between DHHS and CMS involving the initial state proposal with the Atlanta CMS office responding with comments and requests to make changes. DHHS proposed a ninety-day phase in to avoid the midnight flipping of a switch, but CMS did not approve the phasing. There were many negotiations before DHHS had a final definition.

Without further questions or comments from the committee, Chairman Hartsell excused Stewart.

Beth Wood, CPA, State Auditor

Senator Hartsell recognized State Auditor Beth Wood.

Wood stated that she wanted to clarify some items that Mr. Teeter from the Office of the Attorney General said relative to the Office Depot contract. Office Depot, the vendor, found that they were overcharging the State of North Carolina. Office Depot said that they undercharged hundreds of thousands of dollars and "in the goodness of their heart," they were going to pay the state what they overcharged the state and forget about what they undercharged the state. The state auditors requested proof of undercharges, but could not verify that information from the first CD furnished. Then auditors received another CD, but again could not determine that there were any undercharges. She said that she wanted the committee to understand that the auditors did consider the undercharge issue, but could not find any proof that Office Depot undercharged the state.

As to Representative Holliman's question about how the state gets into these situations, Wood said that there were projections on the front end of contracts such as Blue Cross and DMA. There are numbers as to how the contractor will render services and costs. If the projections are flawed, then obviously contractor performance will also be a problem. The key is monitoring after the projections. There is another audit report she will be reviewing for her approval this week. Monitoring is an issue. The agencies involved say that it was the Department of Administration's responsibility to monitor these contracts. Wood said that she knew of no statutory provision as to who has the responsibility for monitoring. If legislation is considered, it should establish who is responsible and even if there were bad projections, monitoring should detect these during the first month that a contract fails to perform as expected.

Representative Goforth asked Wood how the auditor could audit a state contract if there were nothing in writing specifying the percentages and amounts that a contractor could charge for administration and overhead.

Wood said that her office did not. Here office examined the performance of the contract and the projections versus actual. The audit found that the actuary who made the projections of cost of the SHP could not access Blue Cross actual numbers as to what Blue Cross was charging. Her office also could not access that information. Those numbers are not available to anyone.

Representative Luebke expressed concern about Wood's observation that there was no statutory obligation for agencies to monitor costs, to look for exceptions and to flag them.

Wood said that Luebke is correct in assuming that agencies should do this for good stewardship and good resource management. This is obviously an implied obligation. However, as she said earlier, when responding to a pending audit an agency that signed a contract said it was not responsible for monitoring that contract.

Representative Cole asked if in her role as guardian of the purse, had she been denied access by any of the state suppliers to needed information.

Wood said that Blue Cross Blue Shield did.

Representative Cole asked why.

Wood said that the contract states that her office would not be allowed to look at those numbers.

Representative Cole stated that this was inconceivable. He asked if auditors were denied access to information to determine if the millions were spent properly and if they were not that the state does not know.

Wood said that she had an issue with another contract that her office was asked to examine and auditors were not allowed to examine the numbers.

Representative Cole said that was the pharmaceutical supplier. Wood responded yes. Representative Cole said that the supplier was Medco.

Senator Clodfelter stated that his chuckle earlier was not directed at her but at the circumstances she was describing. He said that he had looked at both contracts as a member of the oversight committee and found out after some resistance that he was entitled to look at them. He said that a first year law student during the first day of law school could have done a better job on those contracts.

Representative Cole observed that the discussions kept raising other questions. He asked Wood who in these agencies is authorized to negotiate a contract and sign it wherein the state would have no oversight and affirmed Senator Clodfelter's opinion.

Wood said that she was not certain, but she assumed that the person who signed the contract was authorized to sign. However, she said that she could not say if that was specified by a statute or their job description.

Representative Cole asked if anyone present from Purchasing and Contract (P&C) who could respond.

Don Teeter from the Office of Attorney General said that most contracts that go through P&C are contracts that are let by the agency under the supervision of P&C. That supervision is aimed more at the competitive procurement aspect than the content of the contract. Obviously as P&C considers contracts, many changes are made to most every contract. Because the agency spends appropriated money for contracts—that is an agency responsibility. The agency head signs contracts. Contracts such as Office Depot are "term contracts," which apply to all state agencies and school systems. The Department of Administration lets term contracts. The State Purchasing Officer, Mr. Staton, signs the term contracts. When contracts go through P&C, P&C has teams organized by industry or disciplinary lines, e.g. high tech, services, commodities, etc. The teams are the real level of expertise as to what the industry will bear. That is not elementary learning. The person who has signs is not always the person with the expertise in the industry or area of the economy involved.

Co-Chair Hartsell asked if state contracts have a provision such as that which local governments have requiring a pre-audit provision affixed to the contract to make them enforceable against the entity.

Teeter said that if there is a pre-audit provision, he did not know of it. If there were, it would be for an individual agency where the General Assembly has authorized. When agencies request a contract or a contract form for P&C signature or send out for competition, P&C does not check to see if there is an appropriation or ability to pay. There are agencies that are exempt from the P&C process and some that are not in the executive branch. Some of those that are exempt ask P&C or Construction for assistance. State ports are apart because they are receipt supported.

Committee Discussion

Co-Chair Hartsell asked for committee discussion about proposals for legislation or any follow up with regard to the hearing.

Representative Holliman said that he agreed with Senator Hartsell's suggestion for a pre-audit provision similar to that applicable to local government. In addition, he could support any measure to improve efficiency or to make the process more professional.

Senator Clodfelter suggested that staff make suggestions for legislation and then the committee could debate those.

Representative Langdon said that the contract system should protect the taxpayers and what the state has, apparently does not do that. He suggested that the committee needs legislation that fixes contracting. He told the committee that as a Johnston County official hiring a county attorney that he had the attorney review every contract for potential defects that would hamper performance and that appeared to be what the state needed to do in some way. He observed that he was not an attorney, but that any of the committee members could do better than what others described today.

Representative Cole suggested that staff survey other states for best practices.

Adjournment

With no further business before the committee, the committee adjourned.

APPROVAL OF August 3, 2009 MINUTES:

Co-Chair, Senator Daniel Clodfelter

Co-Chair, Senator Fletcher Hartsell

Co-Chair, Representative Nelson Cole

Co-Chair, Representative James Crawford